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Food for our Future

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Roger L. Larson
President

29th February, 2000

Mr. Vernon A. Williams, Secretary
Surface Transportation Board
Office of the Secretary
Case Control Unit
Attention: STB Ex Parte No. 582
1925 K Street, N.W.
Washington, DC 20423-0001

ENTERED
Office of the Secretary

FEB 29 2000

Part of
Public Record

Dear Sir:

Re: Downstream Impacts of the Proposed Business Combination of Canadian National and Burlington Northern Santa Fe on the North American Rail Industry

The Canadian Fertilizer Institute (CFI) is very interested in participating in STB Ex Parte No. 582. We are submitting the attached Research Paper to outline the impact that further consolidation of the North American railroad industry could have on the member companies of the CFI.

The CFI would first like to applaud the STB's decision to establish a "dual-track" process for exploring not only the direct and specific impacts of this proposed business combination but also the downstream effects on the industry in general. The CFI will not formally participate in a presentation on March 7th but has instead chosen to submit our concerns in a written context only.

The Institute is an industry association representing manufacturers of nitrogen, potash, phosphate and sulphur fertilizers, as well as major wholesale and retail distributors. CFI currently has 39 active members, a list of our Active Members is attached. To a very high degree, we also share membership with The Fertilizer Institute (TFI), Washington, D.C. We are in support of the comments which they have also submitted to you on this issue.

Our industry is made up of primary producers engaged in the mining and/or manufacturing of fertilizer raw materials and finished fertilizers. Canada is the world's largest potash producer and exporter, supplying approximately 85% of U.S. farmers' potash requirements, and is also a major producer of nitrogen fertilizers, supplying 25% of Northern American needs. Sulphur is a major fertilizer raw material, used to produce sulphuric acid for phosphate fertilizer production. Canada is the world's largest supplier of traded sulphur and the United States is the world's largest supplier of phosphate fertilizers.

Canadian Fertilizer Institute / Institut canadien des engrais
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Another perspective is production volume. Our industry produces approximately 24 million metric tonnes of fertilizer, of which we export 18 million tonnes. In addition, there are 5 million tonnes of sulphur exports. It is worthwhile noting that this means that fertilizers are the third largest commodity shipped by Canada's railways. Overall, Canada supplies 12% of the world's fertilizer materials, to over 70 countries. The United States receives roughly two-thirds of these exports, and they play a key role in sustaining American agriculture.

At the outset it is important to indicate that the CFI is not in opposition to this merger. Indeed, we are cautiously optimistic that there may be benefits, which accrue back to shippers as a result of the merger. Past mergers, however, have espoused similar benefits, which have in most instances not been realized by shippers. We perceive the next round of railroad consolidations (including BNSF/CN) will result in a need to counter-balance the market power of the railroads with a regulatory environment that effectively encourages competition and protects shippers with respect to rates and service. This is of utmost concern to our membership and the attached Research Paper, which CFI participated in, discusses these concerns at length. In the event that BNSF/CN are able to adequately address (in the context of STB Finance Docket No. 33842) both the downstream impacts of industry consolidation plus the specific merger (BNSF/CN) related concerns of our members, then the CFI would be willing to consider supporting the BNSF/CN merger.

Once the STB has received public feedback during STB Ex Parte NO. 582 then it is our understanding that the STB will issue conclusions and recommendations with respect to that process. Furthermore, we would anticipate that BNSF/CN in STB Finance Docket No. 33842 will be required to address the STB recommendations from Ex Parte No. 582 as well as specific customer concerns which are directly related to the BNSF/CN merger. The CFI expects to fully participate in the STB Finance Docket No. 33842 and provide BNSF/CN with every opportunity to demonstrate their ability to satisfy our concerns.

Should any further information be required from the CFI, please do not hesitate to contact us and we will do out utmost to provide information in a very timely fashion.

Yours truly,

Roger L Larson

Roger L Larson

Enc: List of CFI Active Members
CFI/CCPA/CITA Research Paper – February, 2000
Shippers' Summit Discussion Paper – December 15, 1999

CFI Member Companies (Active Members)

Basic Manufacturers

Agrium
CF Industries Inc.
Fernz Sulfer Works Inc.
Hydro Agri-Canada L.P.
IMC Kalium Canada Ltd.
Orica Canada Inc.
Pacific Ammonia Inc.
Potash Corporation of Saskatchewan Inc. (PCS)
Saskferco Products Inc.
Sherritt International Corporation
Simplot Canada Limited
Terra Nitrogen
Tiger Industries
Westco Fertilizers

Wholesalers/Distributors

Agro-100 Ltée
Agrico Canada Limited
Agronomy Company of Canada
Border Chemical Company Limited
Cargill Limited
Cavendish Agri Services Limited
Ceres Fertilizers
Chaleur Fertilizers Ltd.
Coopérative fédérée de Québec
CropMate-Division of Con Agra Ltd.
GROWMARK Agronomy
H.J. Baker & Bro. Inc.
International Commodities Export Company of Canada (ICEC)
Imperial Oil Limited
International Raw Materials, Ltd.
James Richardson International Limited
Kent County Fertilizers Ltd.
McCain Fertilizers Ltd.
Saskatchewan Wheat Pool
Shur-Gro Farm Services Ltd.
Sylvite
Transammonia Inc.
United Grain Growers Limited
W.G. Thompson & Sons Limited
William Houde Limitée

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A RESEARCH PAPER ON:

(1) THE PROPOSED COMBINATION OF CANADIAN NATIONAL RAILWAY CO. AND THE BURLINGTON NORTHERN SANTA FE CORP. INTO NORTH AMERICAN RAILWAYS INC. AND

(2) THE PROBABILITY OF FURTHER NORTH AMERICAN RAIL MERGERS

FEBRUARY 2000

CONTRACTED BY:

Canadian Fertilizer Institute (CFI)

Canadian Chemical Producers' Association (CCPA)

Canadian Industrial Transportation Association (CITA)

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<u>Biography of the Author:</u>

Between 1987 and 1992, Mr. Weinberg was a Member of the National Transportation Agency of Canada. He participated in and presided over regulatory matters on panels, hearings and inquiries.
Assignments included:

- administration of the $720 million western grain transportation subsidy;
- five bilateral air agreements;
- several competitive line rates and extended interswitching decisions;
- the proposed Air Canada/Canadian Airlines International merger;
- the VIA Rail pricing inquiry and;
- a public hearing and decision on freight rates respecting the Terms of Union between Canada and Newfoundland.

From 1985 to 1987, Mr. Weinberg worked for the Office of Economic Regulatory Reform, within the Office of the Minister of Transport. The Office was successful in formulating and enacting the new transportation legislation for Canada, the National Transportation Act of 1987.
Key responsibilities were:

- principle participant in the consultative process with industry;
- key components of the drafting of legislation included formulation of competitive access and dispute resolution rail provisions;
- advisor to the House of Commons Standing Committee on Transportation and Senate Standing Committee on Transportation and Communications.

Prior to this work on transportation reform, Mr. Weinberg was the Director of Freight Studies with the Canadian Transport Commission. He joined the federal public service after two years with Shelpac Research and Development and eight years with the Canadian Pacific Ltd. (Canadian Pacific Railway).

EXECUTIVE SUMMARY

A. Summary of the Key Implications for Shipper Competitive Options

1. Restriction of Canadian Shipper Routing Options Over Canada/U.S. Gateways

Canadian shippers have traditionally enjoyed the right to route the long haul portion of cross border movements to competing railroads at Canada/U.S. interchanges. Today, a shipper has the right to select either (1) a "through freight rate" between a point of origin and a point of destination, or (2) a freight rate from a point of origin to an interchange gateway and an American Association of Railroads (AAR) Rule 11 freight rate beyond the interchange to U.S. destinations. In contrast, under the U.S. Staggers Act, the railroads have the right to control long haul routings. Given that the primary objective of the proposed CN/BNSF merger is the promotion of single line movements from origins to destinations, it is highly probable that international freight rates from Canadian origins to U.S. destinations would be quoted only as "through freight rates", that is, shippers would not be offered rates to existing interchanges with a connecting carrier. Furthermore, the imposition of a rules tariff, similar to CN Tariff 6061-A, by the merged CN/BNSF, would preclude the Rule 11 routing options which could offer lower combination rates than single line through rates. The railroads refer to this as "gateway closure". BNSF already practices "economic closing" of gateways by Item 230 of BNSF Tariff 90004, which names distance-based fertilizer rates when used for proportional rate purposes (Rule 11). These require BNSF to get their maximum haul from or to interchanges with connecting carriers.

2. Reduction of Traditional Captive Shipper Routing Options from Two to One, Thereby Reducing Shipper Choices

The proposed CN/BNSF merger would reduce shipper routing options from the present two-option scenario to a single line routing over the combined railroad. At present, a shipper captive to CN could route traffic to Vancouver, for example, and seek a Rule 11 routing with a connecting carrier, or combination of carriers, to the U.S. destination. Following the merger this cross border traffic would be routed on CN/BNSF from origin to destination, thereby eliminating routing combinations with other carriers, which might be available.

3. Reduction of the Effectiveness of the Competitive Access Provisions of the Canada Transportation Act, 1996 (CTA), thereby reducing shipper choices

For cross border movements, the proposed CN/BNSF merger would clearly undermine and significantly erode the competitive access provisions contained in the Canada Transportation Act, 1996 (CTA) by the elimination of a connecting carrier and the provision of "single line service" between origin and destination. This would result in a loss of competitive routings for shippers' traffic, i.e. CP/BNSF and ultimately Canadian Pacific /Union Pacific (CP/UP) routings. Shippers having dual physical access to two railways, at either origin or destination, would also be affected in the same fashion as those having competitive access by virtue of Canada Transportation Act, 1996 (CTA) provisions.

4. The Cross Border Jurisdictional "Gap"

Rail movements between Canadian origins and Canadian destinations are subject to Canadian jurisdiction under the Canada Transportation Act, 1996 (CTA). U.S. movements are subject to jurisdiction under the Surface Transportation Board. Cross border movements are subject to two different jurisdictions with very different regulatory regimes. The proposed CN/BNSF merger would operate single line service across the two regulatory jurisdictions and it is not clear which regulatory regime, if any, would govern cross border single line through freight rates and services. Unless this gap in jurisdiction is addressed, the railroads would undoubtedly seek to "self regulate" these matters.

The Canada Transportation Act, 1996 (CTA) provides for the final offer arbitration of freight rate and service disputes between captive shippers and railways under Canadian jurisdiction. It is not clear whether this dispute resolution mechanism would apply to disputes concerning international through "single line" freight rates on CN/BNSF originating or terminating in Canada.

5. The Dispute Resolution Procedure and Final Offer Arbitration

If the CN/BNSF merger is approved, it could lead to the rapid consolidation of the North American rail industry. As consolidation proceeded towards just two transcontinental railways it would severely impede the ability of shippers to utilize competitive access provisions in either Canada or the U.S., even if such provisions were in effect. If the railroads remaining in a future North America railroad duopoly should choose not to compete with one another, perhaps to avoid retaliatory action elsewhere on their networks, it would be essential for regulatory authorities to provide or maintain effective dispute resolution mechanisms, such as Canada's Final Offer Arbitration, to address both rate and service issues.

6. Possibility of Tariffs being "Self Regulated" by the Railways in the Future

Particularly if rail consolidation proceeds beyond the proposed CN/BNSF merger, there is a real probability that shippers could be faced with a return to a system whereby all freight rates are set in published tariffs and the use of confidential contracts is considerably curtailed. At least one U.S. railroad, CSX, has indicated that it plans to move in this direction. This would return the rail industry to a similar situation which existed during the years of rate regulation but with one significant difference – there would be no controls on the rates. If the railways should be left to "self regulate" their own tariff rates, this would expose shippers to a considerable risk of excessive rate increases from a service industry which exists primarily to serve shipper requirements.

7. Impacts on Cross Border Shippers having Multiple Shipping Options

Cross border shippers currently having multiple competitive rail options for their shipments, e.g. three or four options, could be severely restricted in the future as their options would undoubtedly decrease by at least one if the proposed CN/BNSF merger is approved and could well decline by a further option following the next major rail merger, when that occurs.

B. Recommendations for Preserving and Enhancing Rail Competition in the Event of the Proposed CN/BNSF Merger and Possible Future Rail Mergers

1. Preserve and Enhance Competitive Access Mechanisms

In the short to medium term, Canadian regulators should preserve and enhance Canada's competitive access mechanisms (e.g. by removing the subsection 27 (2) "substantial commercial harm " test from the Canada Transportation Act, 1996 (CTA) and by enacting the Competitive Access Rate proposed by the *Shippers' Summit* group). Even if the proposed CN/BNSF merger is ultimately approved, the competitive access mechanisms should continue to be useful to shippers in some situations. If further mergers should take place, however, Canada's competitive access experience to date demonstrates that these mechanisms are likely to lose their effectiveness as the remaining railways decline to compete with one another. Railways could move towards moving freight under published tariffs rather than negotiating confidential contracts, a move that would gradually dismantle today's market-oriented negotiation of rail rates and services. If this should occur, regulatory authorities in Canada should intervene and develop new shipper protections.

2. Formalize CN and BNSF Rate and Service Guarantees through Rulemaking

On February 11, 2000 CN and BNSF jointly provided a "guarantee to rail shippers" guaranteeing the same or better service levels; that today's routes will remain available; that existing gateways will remain open; and that a service alternative for two-to-one shippers will be assured. These guarantees should be adopted by Canadian and U.S. regulatory authorities in their rulemaking in a manner that would make them legally enforceable by shippers.

3. Abolish Tariffs Which Restrict Competition

Canadian and U.S. regulatory authorities should prevent railway use of restrictive tariffs intended to preclude shipper use of routing options such as those which can be achieved through application of Rule 11.

4. Order New Railway Running Rights to Crossborder Interchange Points

Both the Port of Vancouver and Winnipeg interchange gateways with CN are exclusively served by BNSF. The appropriate regulatory authorities should order running rights for other Class 1 railroads (e.g. the Union Pacific Railroad) to these interchanges, and to the interchange at Coutts, Alberta, in order to preserve competitive transportation options and to avoid market dominance at these gateways if the proposed CN/BNSF merger is approved. This would increase competitive options for Canadian shippers to U.S. destinations and for U.S. shippers to Canadian destinations. This would follow the precedent established by the Surface Transportation Board in the U.S. which ordered UP running rights over BNSF into Roberts Bank in British Columbia as part of the Burlington Northern Santa Fe merger and ordered CP running rights into New York City as part of the CSX Corp. and Norfolk Southern Railroad takeover of the former Conrail.

5. Create an Effective Dispute Resolution Mechanism such as Canada's Final Offer Arbitration

Canadian and U.S. regulatory authorities need to develop an effective dispute resolution mechanism applying to cross border single line through rates and services. Moreover, U.S. authorities should consider enacting a more effective dispute resolution mechanism in view of the reduction of competitive options which would accompany the CN/BNSF merger, if it is approved, and the further reduction of competitive options which would be associated with future rail mergers. If such mergers should impede the ability of shippers to utilize competitive access provisions, they will turn more and more to dispute resolution. The Canadian Final Offer Arbitration model, which has proven its effectiveness for resolving freight rate and service disputes between captive shippers and railways, should receive serious consideration in the design of any new dispute resolution procedures.

TABLE OF CONTENTS

INTRODUCTION

The Proposed CN/BNSF Combination or Merger

On December 20th, 1999 the Canadian National Railway Company (CN) and the Burlington Northern Santa Fe Corporation (BNSF) announced agreement to "combine their businesses" through a $28 billion merger to create "North America's largest railroad" to be known as North American Railways, Inc.. The proposed combination is scheduled to be reviewed by the Surface Transportation Board in the United States commencing in March of 2000 and by the Bureau of Competition Policy in Canada.

Some relative statistics for the partners in the proposed transaction are:

	Canadian National	Burlington Northern Santa Fe
Head Office	Montreal, Québec	Fort Worth, Texas
Employees	23,500	43,000
Miles of track	26,700 Km.	64,000 Km.
Locomotives	1,650	5,000
Freight Cars	66,000	98,000
1999 Revenues	$5.2 billion Canadian	$13.5 billion Canadian

The BNSF corporate entity clearly overwhelms the CN in every relevant respect by several orders of magnitude. Notwithstanding the plans for locating the headquarters of North American Railways, Inc. in Montreal, the economic and corporate control of the proposed merged entity is likely to reside in Fort Worth, Texas.

Canada's National Transportation Policy

The legal framework governing transportation in Canada is contained in the National Transportation Policy set forth in section 5 of the Canada Transportation Act which states, in its introduction (italics added for emphasis):

"It is hereby declared that a safe, economic, efficient and adequate network of viable and effective transportation services accessible to persons with disabilities and that makes the best use of all available modes of ***transportation at the lowest total cost*** is essential to serve the transportation needs of shippers and travelers, including persons with disabilities, and to maintain the economic well-being and growth of Canada and its regions and that those objectives are most likely to be achieved ***when all carriers are able to compete, both within and among the various modes of transportation,*** under conditions ensuring that, having due regard to national policy, to the advantages of harmonized federal and provincial regulatory approaches and to legal and constitutional requirements, ..."

In addition, section 5 (b) of the Policy states that "***competition and market forces are, whenever possible, the prime agents in providing viable and effective transportation services***".

The Parliament of Canada, through this Policy, clearly intends that shippers are entitled to competition and "transportation at the lowest total cost".

The National Transportation Policy Responds to Canada-U.S. Differences in Transportation Infrastructure

There are fundamental differences between Canadian and U.S. transportation infrastructure. Six Class 1 mainline railways currently serve shippers in North America. Two Class 1 railways operate across Canada. The Canadian National Railway operates from coast to coast between British Columbia and Nova Scotia. Canadian Pacific Railway operates between British Columbia and Quebec. In the U.S., there are four Class 1 mainline railroads which essentially operate on a regional basis. The BNSF and Union Pacific (UP) Railroad essentially operate west of Chicago while the CSX Corporation and Norfolk Southern Railroad operate east of Chicago.

But in addition to their Class 1 railroads, U.S. shippers also have access to a far greater number of transportation alternatives than their Canadian counterparts. This is especially significant because in Canada, the rail dependent resource-based sector is of considerably greater importance to the domestic economy. It must ship longer distances in order to market products having lower unit values. One of the key U.S. transportation alternatives to rail is the publicly maintained Mississippi River system which provides a major north/south transportation corridor for substantial freight traffic. Canada has no equivalent of the Mississippi system as a natural, competitive transportation corridor. U.S. shippers can also use an extensive east/west interstate highway network funded largely by a public gasoline tax. In Canada, on the other hand, the national highway system is only single lane through large portions of the country and inadequate for large-scale heavy trucking. The federal and provincial governments acknowledge that the highway system is inadequate, deficient and in need of major capital improvements. Those improvements have been the subject of funding discussions between the governments for a number of years.

In recognition of this lack of effective transportation alternatives as well as the historic existence of a railway duopoly in Canada, our rail transportation legislation has included provisions providing intramodal competitive access at interchanges for many years. The first such provision was regulated interswitching within prescribed distances between CN and CP, as well as between Canadian and U.S. railways. The National Transportation Act of 1987 added competitive line rates (CLRs) which essentially consist of interswitching with a prorated mileage component to cover greater distances from interchanges. CLRs provide intramodal competitive access for captive shippers located well beyond the prescribed interswitching limits. Many of those shippers are located remote from interchanges with domestic or U.S. railways in the resource producing western provinces. While the Canada Transportation Act of 1996 constrained access to CLRs to only those shippers able to demonstrate "substantial commercial harm" by virtue of the level of their railway freight rates, in recognition of the transportation and logistical disadvantages existing in Canada the legislation preserved unencumbered the Final Offer Arbitration of freight rate disputes between captive shippers and railways.

In summary, Canada is an exporting nation, dependent upon U.S. and offshore markets. Since implementation of the North American Free Trade Agreement rail shipments to U.S. markets have increased significantly. Canadian shippers are linked to those markets by a duopoly of Canadian Class 1 railways connecting with U.S. Class 1 railroads at interchanges located at or near the international border. For many rail dependent resource-based shippers, transportation distances to markets are great and there are generally no economically feasible transportation alternatives. Other shippers throughout the economy can face the same situation. Many of them are at a transportation disadvantage relative to alternative foreign sources of supply, whether that source of supply is in the U.S. or elsewhere. Canada's transportation legislation must continue to take account of this as the railways in our existing duopoly merge with U.S. railroads.

RAIL INDUSTRY REACTION TO THE PROPOSED CN/BNSF MERGER

The Initial Reaction

A Globe & Mail January 18th, 2000 article titled "Four Railways Fire the First Shot To Derail CN-BNSF Merger-Could Lead to Just Two Mega-Railways in North America" referred to an open letter which appeared in both the Wall Street Journal and Journal of Commerce, signed by the Canadian Pacific Railway, the Union Pacific (UP) Railroad, the Norfolk Southern Railroad and the CSX Corporation. These four Class 1 railroads cautioned that the proposed merger, if approved, would ultimately lead to just two large rail systems serving North America, down from the current six. They also cautioned that they would be (emphasis added) "forced to develop strategic responses to a combination of CN and BNSF and that could include ***a merger of their own***". They said that "history teaches that this will be the result" and that "no major member of the rail network can afford to stand still while another becomes disproportionately larger".

The letter was signed by Mr. Robert Ritchie, President and Chief Executive Officer of the Canadian Pacific Railway and his counterparts at the three other railroads. In the letter Mr. Ritchie and the other executives said that they had "***serious concerns***"about the potential impact of the proposed merger and advised cargo shippers "to take their concerns to the Surface Transportation Board", the U.S. regulatory body that must approve the $28 billion deal. The spokesperson for CSX, Mr. Craig MacQueen, was quoted in the January 12th, 2000 National Post as warning that "if other railways are forced to respond by merging it could lead to ***re-regulation of the industry***".

The Canadian Pacific Railway "Merger Imperative"

If it is approved, the proposed CN/BNSF merger would leave the Canadian Pacific Railway sandwiched between CN and the BNSF Railroad. Without an effective partner CP will become isolated and ineffective because CN/BNSF can simply raise their revenue requirements over existing gateways, preventing joint rates from competing with single-line CN/BNSF hauls.

The BNSF serves the large U.S. West Coast container ports of Seattle and Tacoma. Containers are moved in unit trains to Chicago distribution centers where they are distributed to destination by truck or rail. A large quantity of Canadian-destined container traffic from Asian markets enters North America through these ports. Tacoma, although a U.S. port, takes pride in referring to itself as "Canada's largest container port" due to the significant volumes of Canadian container traffic it moves. Under the proposed merger, CN/BNSF would be able to offer direct rail service from the U.S. West Coast into the important Ontario and Quebec markets. The traffic would be routed over the BNSF lines to Chicago as at present. From Chicago, the traffic would move over CN lines, south of the Great Lakes, through the new Sarnia/Port Huron tunnel, then over CN lines in Canada directly into eastern Canadian markets. This would be in direct competition with CP container service from Vancouver to the same eastern Canadian markets.

CP has invested heavily in marine container ships and has emerged as the world's tenth largest marine container carrier, largely through the Lykes acquisition which it merged with Canada Maritime. In a recent interview with the Report on Business, Mr. David O'Brien, Chairman of Canadian Pacific, stated that the CP container business has grown from 300,000 units to 1.8 million units per annum in only a few years. To support this traffic, CP has invested heavily in improving all tunnel clearances, upgraded container handling facilities and made major yard and track improvements. CP generally moves this container traffic across the country to eastern Canada through the Port of Vancouver. Much of this investment would be placed under new competitive risk by the proposed merger.

Knowledgeable railway observers suggest that the factors outlined above will drive CP to seek a merger partner in the relatively near future. The UP would be a potential partner because it has the critical size and market power to match BNSF. It serves Seattle, Tacoma and Long Beach container ports which is certainly attractive to CP, particularly since CN would have access to these ports by virtue of the proposed merger. For its part, UP should be interested in partnering with CP considering the new competitive realities which would be created by the proposed CN/BNSF merger.

The Probability of Future Transcontinental Railway Mega-Mergers

The approval of the proposed CN/BNSF merger would hasten further railroad mergers for competitive reasons. This would ultimately result in the current six Class 1 railroads being reduced to just two mega-merged railroads with "seamless" railroad operations operating from coast-to-coast, north to south, east to west and across North America, without regard for national borders. This is no longer a hypothetical possibility but rather, a competitive reality. A previous section of this discussion paper has outlined why the four Class 1 railways other than CN and BNSF believe that if the proposed merger proceeds, they would have to pursue "defensive mergers" to protect their competitive positions in the North American transportation marketplace.

The logical outcome of such defensive mergers, following the proposed CN/BNSF merger and a possible CP/UP merger, would be respective transcontinental mergers between each of the newly-merged western railroad entities and one of the two eastern regional railroads, i.e. the CSX Corporation and the Norfolk Southern Railroad. The clear market dominance of CN/BNSF and CP/UP merged entities would make further merger activity of this nature commercially necessary. Both eastern railroads serve the important Atlantic ports of New York, Boston, Philadelphia, Baltimore and the New Jersey ports. Significant freight traffic originating in this region on the two eastern railroads is destined to markets west of Chicago, beyond the reach of these carriers. The merger will permit CN/BNSF to short-haul CSX and NS on eastbound traffic via the CN Buffalo, CN Port Aaron and CN Detroit gateways. Similarly, much freight traffic originating in the western region on the western carriers terminates east of Chicago, so that mergers with the eastern carriers would also make commercial sense from their perspective.

For a newly merged CP/UP, an additional merger with an eastern U.S. railroad serving Atlantic container ports would be extremely attractive. The proposed CN/BNSF merger's "Atlantic CN Link" is being promoted as benefiting the ports of Montreal and Halifax by increasing the amount of freight traffic shipped through those ports. It purports to make Halifax the pre-eminent port on the Atlantic Coast. A CP/UP merger with an eastern regional railroad serving major eastern U.S. ports would strongly challenge that contention since Halifax is in direct competition with those ports.

The Expectations for Rail Pricing in an Era of Transcontinental Mega-mergers

Confidential contracts originated in Canada in response to the requests of the railways to be put on a " level playing field" with U.S. carriers on international railway movements. In an era of transcontinental railway mega-mergers, leading to just two major North American railways, there would no longer be an issue of Canada/U.S. railway competition. Given the overwhelming market power which two major railways would have, and the small likelihood of intramodal competition between them, there could eventually be a need to return to rate transparency through published tariffs. Rail dependent captive shippers facing "single line service" could be reluctant to be "railroaded" by duopolies having significant market power under the cover of confidentiality. This could lead to a return to the era of published tariffs. Regrettably, it could also lead to a return to rate regulation of some form since in the past, the rate levels were administered by independent regulatory bodies.

Regulators in Canada and the United States should take these factors into account now in considering the merits of railway mergers by assessing their possible longer-term impacts on today's market-oriented North American rail transportation system.

COMPETITION ISSUES ASSOCIATED WITH END-TO-END RAILWAY MERGERS

The Commercial Rationale for End-to-End Railway Mergers

The fundamental commercial rationale for the end-to-end mergers of Canadian and U.S. railroads has little to do with the duplicative plant, equipment or labour rationalization considerations which were factors in three recent U.S. railroad mergers or acquisitions (Burlington Northern and the Atchison, Topeka & Santa Fe; Union Pacific (UP); and the Norfolk Southern and CSX Corporation acquisition of Conrail). Rather, the commercial rationale for north/south Canada/U.S. railroad mergers consists of:

(1) The increased "market power" associated with the combined scale of railway operations.

(2) The creation, control and retention of increased long haul traffic movements between origin and destination.

(3) The reduction of competitive rail options to long haul routings so as to maximize the long haul traffic movements.

(4) The creation, where possible, of new long haul arrangements made possible by combining and merging railway plants.

Long haul traffic movements are generally the most profitable commercial arrangements for railways on particular traffic movements. The reason is very simple. The highest costs which a railway incurs on traffic movements is generally incurred in the switching of cars at origin and destination. Those activities are both time consuming and labour intensive. These costs are spread over the distance of haul. The longer the railway haul, the lower the average cost of the movement and hence, the greater the profitability of the long haul movement to the railway.

Railways seek long haul movements and mergers maximize long haul movements. For these very same reasons, railways oppose competitive access provisions like interswitching and competitive line rates, neither of which are available in the United States. These competitive access provisions could leave the originating carrier bearing the major cost elements of the movement to the interchange and expose it to the possible loss of the more profitable, longer line haul. This is the reality of the economic cost of competitive access from a railway perspective and the reason why mergers are attractive. They simply provide longer line hauls.

An additional point worth mentioning is that the freight rates of captive shippers almost always yield a higher "contribution" to the railroads. This is consistent with the Ramsey pricing model underlying the U.S. Staggers Act which assumes that shippers without railroad competition pay disproportionately higher railroad contributions. Those higher contributions are maximized the longer the line haul, and hence the rationale for end-to-end mergers, single line movements and seamless operations. Accordingly, there is an overriding requirement to condition any approval of the proposed CN/BNSF merger with provision for competitive access providing even a semblance of a quasi-competitive market environment for those captive shippers most vulnerable to market abuse. Unfortunately, for circumstances already described in this discussion paper, their number is considerably higher in Canada as a proportion of total railway traffic compared to the United States with its greater variety of transportation options.

Competitive Access Provisions of the Canada Transportation Act, 1996 (CTA)

The fundamental objective of competitive access provisions is the creation of ***rail to rail competition*** at an ***interchange*** between ***competing railways***. The traffic is captive to the originating carrier until it reaches the interchange. At the interchange, however, the shipper can solicit competitive bids for the traffic from competing carriers to move it to ultimate destination. In effect, the shipper is able to offer the long haul to tender between competing carriers at the interchange, in exchange for either a better rate, better service or perhaps a better routing. Fundamental to each of the competitive access provisions described below, and intramodal competition between railways, is the availability of an interchange. An interchange is simply defined as a location where the line of one railway company connects with the line of another railway company and there is adequate siding capacity available to store freight cars. The latter facilitates the handling of the traffic between the railways.

The competitive access provisions of the Canada Transportation Act, 1996 (CTA) intended to provide rail competition for shippers on a rail line served by a single railway carrier are regulated interswitching, extended interswitching and competitive line rates (CLRs). Regrettably, the Canada Transportation Act, 1996 (CTA) introduced the subsection 27 (2) substantial current commercial harm test which virtually eliminates the usefulness of the latter two competitive access mechanisms.

Regulated interswitching applies if a shipper has access to only one railway carrier at origin or destination. The shipper may have its cars interswitched (i.e. transferred) from that rail carrier to another at rates prescribed by the Canadian Transportation Agency, providing its siding is within a 30 kilometer radius of the point of interchange. A shipper may apply to the Agency for extended interswitching rights beyond the 30 kilometer limit, provided that the shipper is "reasonably close" to the interchange and can demonstrate substantial commercial harm.

Captive shippers who are beyond the 30 kilometer interswitching limit and can satisfy the substantial commercial harm test can also apply to the Agency for the establishment of a CLR for the movement over the railway lines serving the shipper to the interchange. Arrangements must first be completed with the connecting carrier for the movement of the traffic on to the destination. While past behavior is not necessarily indicative of the future, it is worthwhile noting that even though Burlington Northern was once the only railroad willing to participate in a CLR as a connecting carrier to destination, it has not done so since 1991. Clearly, the substantial commercial harm test and the requirement to first complete arrangements with a connecting carrier limit the use of CLRs.

For the purposes of discussing the proposed CN/BNSF merger and a possible CP/UP merger, this discussion paper deals only with interchanges in western Canada, west of Winnipeg, Manitoba. There are eight interchange points between Canadian and U.S. railroads in this region. Six of them involve BNSF as the predominant connecting U.S. carrier. CP has five interchanges with BNSF; CN has three such interchanges; there is a single interchange between CP and the UP and finally, there are two interchanges between CP and its subsidiary, the SOO Line. These interchanges can be summarized as follows:

Vancouver B.C./Vancouver, Wash.	CP/BNSF *CN/BNSF
Huntingdon, B.C./Sumas, Wash.	CP/BNSF
Kingsgate B.C./Eastport, Wash.	CP/UP
Coutts Alta./Sweetgrass, Mont.	CP/BNSF
Northgate, Sask./Northgate, N. Dak.	*CN/BNSF
Portal, Sask./Portal, N. Dak	CP/SOO
Winnipeg/Emerson, Man/Noyes, Minn	*CN/BNSF
Emerson, Man/Noyes, Minn	CP/BNSF CP/SOO

The most westerly connection or interchange between CN and BNSF is at Vancouver, British Columbia. The major eastern interchange is at Winnipeg/Emerson, Manitoba. CN also connects with BNSF at the important Chicago gateway. The proposed merger of CN and BNSF would integrate the railway plants and operations of the two railroads into a single mega-railroad, connecting at both Winnipeg and Vancouver. Given that the primary objective of the proposed merger is the promotion of "single line movements from origins to destinations", there is every reason to believe that international freight rates from Canadian origins to U.S. destinations would be North American Railway Inc. "through freight rates", that is, shippers would not be offered rates to existing interchanges with connecting carriers. While such connecting rates are currently a shipper "right" in Canada, this is not the case in the U.S. where the railroad is considered as being "entitled" to the long haul.

The Likelihood that Intramodal Competition would Decline in a Post-Merger Era

Even assuming the removal of the "substantial commercial harm" barrier to competitive access from the Canada Transportation Act, 1996 (CTA), what is the prognosis for competitive access in a post-merger era? One need go no further than the opening sentences of the joint announcement by CN and BNSF of their proposed merger. The clear primary objective is the creation of "single line" and "seamless" long haul freight rates between Canadian origins and U.S. destinations.

Undoubtedly, certain service improvements should result from a "seamless" operation and end-to-end merger of the two railroads. The overriding commercial objective of the merger, however, is the potential for longer single carrier long haul movements for reasons already discussed in this paper. The proposed CN/BNSF merger differs in this important respect from the earlier U.S. railroad mergers involving economies in plant rationalization and elimination of duplicate competitive trackage.

Competitive access is the antithesis of this merger objective. How would the merger partners protect the long haul movements which are the fundamental rationale for their merger? It is informative to examine CN Tariff 6061-A to help provide the answer. This tariff has applied to international (Canada/U.S.) movements of forest products. The tariff was in effect from 1995 as Tariff 6061 and then Tariff 6061-A was issued on March 18th, 1999. An extract of the relevant sections of that Tariff is attached as Appendix 1. While it has since expired, it has almost certainly been replaced by a similar tariff. The overriding concern is that what now applies to forest products could easily be made applicable to international shipments of any other products, particularly since the long haul is the principal objective of the proposed merger.

Tariff 6061-A does not set out particular freight rates. It contains rules and regulations which restrict the use of any other rate combinations if they undercut or defeat a CN published rate between an origin and destination. Item 140 of the tariff restricts shippers from using proportional rates, local and combination rates in any rate combination which would be below, or undercut, a CN established joint international "through" rate. The tariff also contains onerous penalty charges (see item 571 which specifies a penalty of $1,224 per carload) on shippers who attempt to avoid CN through rates contained in CN tariffs where CN is a participating carrier over any portion of the movement. Following a CN/BNSF merger, the restrictions and penalties contained in the tariff could easily be extended and imposed on international through rates applying to all product movements in order to limited intramodal competition.

If the CN/BNSF merger is approved and further mergers follow, railways could urge that the U.S. regulatory regime should also be imposed in Canada. CN, for example, has already advocated the "commercialization" of interswitching rates similar to U.S. reciprocal switching. Under the U.S. regime, there are no provisions for competitive access similar to those in Canada. While its reciprocal switching is similar in concept to interswitching, reciprocal switching occurs at so-called "commercial rates" which can be an order of magnitude greater than the regulated interswitching rates prevailing in Canada because they are "negotiated" with captive shippers. Hence, the imposition of the U.S. regulatory system in Canada would mean an end to regulated interswitching as it is currently known. Since interswitching is the primary source of competitive access for Canadian shippers, its elimination would severely disadvantage competitive logistics and economic development of numerous companies across the country.

Given the dominance of BNSF in the proposed merger, there is also a strong possibility that Ramsey pricing prevalent in the U.S. would be urged upon Canada by the railways in the course of this year's review of the Canada Transportation Act, 1996 (CTA). Even if Canada rejects this form of pricing, a newly merged CN/BNSF could still attempt to apply it according to the U.S. practice. CP has also urged the government to introduce demand based differential pricing in the recent grain transportation review which, in essence, is the U.S. Ramsey pricing regime.

The Need To Strengthen Rail To Rail Intramodal Competition And Dispute Resolution In Response To Rail Mergers

A railway duopoly (two major railways in a particular transportation market) has prevailed in Canada for over a century. Canadian shippers have learned to their detriment that in a transportation market having only two railways, there is little or no rail to rail competition other than through regulated interswitching. This would also be the probable outcome if future railway mergers should result in only two major North American railways.

Competition in a duopoly requires an interchange connection between the two railways and the capacity to store rail cars, together with the willingness of the carriers to compete on price and/or service. The missing ingredient for intramodal competition in Canada has been the willingness of the two Canadian carriers to compete other than within the scope of regulated interswitching.

There is ample evidence of this. For example, the Hon. Willard Estey, a former Chief Justice of Canada, in his final report on the grain handling and transportation review dated December 21st, 1998 stated that "Many of those appearing before the Review with the exception of the railways maintained that there is no competition in the real sense of that term between the two railways in the delivery of transportation services across this industry in Canada". Furthermore, while regulatory provisions for competitive line rates have been in Canadian railway legislation since 1988, there has never been a competitive line rate between CN and CP over this period, nor has the Union Pacific (now UP) CSX, Norfolk Southern or the former Conrail participated in a competitive line rate as a connecting carrier.

Indeed, the report of Canada's 1992 National Transportation Act Review Commission stated that "CN and CP have effectively declined to compete with each other through CLRs (competitive line rates) and as a result the provision is largely inoperative in

Canada". The lesson is that by and large, duopolies simply do not compete. They are concerned with the maximizing of revenues on their market share. They are not inclined to offer lower prices for competitive reasons or the risk of retaliation elsewhere which could erode the revenue base. Hence, the concept of intramodal competition in a railway duopoly is largely meaningless and attempts to introduce such competition would be futile.

Nevertheless, in the short term following the CN/BNSF merger, should it be approved, consideration should be given to strengthening the competitive access provisions. They would still be relevant in a number of situations, at least until further railway mergers occur. In addition, the Final Offer Arbitration (FOA) process must continue in Canada and U.S. regulatory authorities should closely examine it. In the absence of effective competition, the FOA of rate disputes would be the only means of constraining monopoly pricing power.

FOA requires a captive shipper to establish that he "has no alternative, effective, adequate and competitive means of transporting his goods". The reluctance of the railways to compete on competitive line rates at the nearest interchange has been an excellent way to establish that a shipper is captive. An independent arbitrator, agreed upon by both parties, assesses the merits of the cases they present and chooses one or the other of the two final offers, but nothing in between, rendering a decision within 60 days. The process is entirely fair to the railways since unlike most shippers, they have the advantage of the experience gained in a number of FOAs. Railways can be expected to present very strong FOA cases but ultimately, they must defend their monopoly pricing practices. The captive shipper has a 50/50 chance of having his offer accepted by the arbitrator which is much better odds than under any other regulatory provision.

PHYSICAL CONSTRAINTS POSED BY THE PROPOSED CN/BNSF MERGER

The impacts of these constraints on Canada/U.S. international freight rates will be evaluated in terms of shippers captive to CN; shippers captive to CP; and shippers captive in the U.S. to either BNSF or other railways such as UP. These scenarios will be evaluated by considering both the proposed CN/BNSF merger and possible future mergers such as CP/UP. This approach provides the nine routing scenarios examined below.

1. The Impact of the Proposed CN/BNSF Merger on Shippers Captive to CN

Since the principal objective of the CN/BNSF merger is to maximize "single line CN/BNSF routings" it is to be expected that to the extent possible, the Canada/U.S. traffic of captive shippers would be routed in a manner so as to maximize transit distances over the merged CN/BNSF. Depending on specific destinations and to the extent possible, traffic would be routed over the Vancouver, Northgate and Winnipeg gateways between CN and BNSF.

There would be every likelihood of restrictive routing tariffs similar to CN Tariff 6061- A being introduced to guarantee the long haul movement for CN/BNSF. To the extent that shippers currently utilize any portion of alternative routings their choices would definitely be reduced by the proposed merger. For example, many possible CP/UP options may be eliminated. The loss of routing flexibility by shippers could result in freight rate increases, especially for traffic which requires further movement by another carrier.

In fairness, there should be a real probability of improved service resulting from single line seamless movements but for captive shippers, this would likely be more than counterbalanced by reduced competitive options and reduced prospects for competitive freight rates.

2. The Impact of the Proposed CN/BNSF Merger on Shippers Captive to CP

Shippers captive to CP would likely retain the same routings and options they now have, assuming no immediate merger activity on the part of CP. The competitiveness of these routings is at risk, particularly for destinations that are local to BNSF. If, however, CP should respond to the proposed CN/BNSF merger by embarking upon its own merger, then scenario 5 below would apply.

3. The Impact of the Proposed CN/BNSF Merger on U.S. Shippers Captive to BNSF

U.S. shippers captive to BNSF with destinations on CN would likely be routed over the CN/BNSF Vancouver, Northgate and Winnipeg gateways. Depending on specific destinations, traffic could also be routed to CP over the several BNSF interchanges with

CP and/or interchanges with the SOO Line. The effects would be similar to scenario 1 above.

4. The Impact of the Proposed CN/BNSF Merger on U.S. Shippers Captive to Other Railways

U.S. shippers captive to other railways would be able to continue present routings over SOO Portal, SOO Emerson and UP at Eastport. They could also use various routings connecting the CN/BNSF merged railway to CP/BNSF gateways. The specific U.S. interchange locations for these railways with the merged railway would depend upon service considerations and negotiated rate divisions. In summary, there would be no material effect on these shippers.

5. The Impact of a Possible CP/UP Merger on Shippers Captive to CP

Similar to the proposed CN/BNSF merger, an objective of a possible CP/UP merger would be to maximize single line long haul routings. It would be expected that to the extent possible, the Canada/U.S. traffic of captive shippers would be routed in a manner so as to maximize transit distances over the merged CP/UP lines. Depending on specific destinations and to the extent possible, traffic would be routed over the Kingsgate, British Columbia interchange with the UP. Traffic would also be routed over the SOO interchange at Portal, Saskatchewan to Chicago, and the SOO interchange at Emerson, Manitoba. To the extent that traffic presently moves along these routings, there is a possibility of improved seamless service, but shippers would have fewer competitive options and reduced prospects for competitive freight rates. There would also likely be a loss of the CP/BNSF routing flexibility which is the most efficient routing to most of the BN local points.

6. The Impact of a Possible CP/UP Merger on Shippers Captive to CN

If the proposed CN/BNSF merger is successful, the impact on CN captive shippers would be no different than as described in scenario 1 above. CN shippers would, however, probably no longer have the CN/UP routing flexibility for local UP destinations

7. The Impact of a Possible CP/UP Merger on Shippers Captive to UP

U.S. shippers captive to the UP, shipping to western Canadian destinations on CP, would likely be routed over the merged CP/UP routing. The existence of only a single interchange with CP at Kingsgate, British Columbia would limit routings into western Canada. To the extent that there are other connections between the UP and the SOO Line, UP/SOO Line routings could be used to connect to the CP at Portal, Saskatchewan. There are four BNSF interchanges with CP and several interchange connections between the UP and BNSF. Depending upon negotiated rate divisions and service considerations, there would be possibilities of UP/BNSF/SOO routings to CP destinations in western Canada.

8. The Impact of a Possible CP/UP Merger on Shippers Captive to Other Railways

U.S. shippers captive to other railways could be able to continue present routing patterns, with the CP/UP attempting to maximize mileage over its merged lines. These would include routings over the SOO Line at Portal, Saskatchewan, the BNSF/SOO Line at Emerson, Manitoba, and the BNSF/CP gateway at Coutts, Alberta. The feasible routings would depend upon service considerations and negotiated rate divisions. If the traffic destination is on CP, the CP/UP could request switching to the UP as close to origin as possible, or offer unattractive rates for the traditional switch location.

9. The Impact of the Proposed CN/BNSF Merger and Possible CP/UP Merger on Shippers having access to both CN and CP in Canada and both BNSF and UP in the U.S.

There are two possibilities under this scenario. The optimistic scenario would foresee shippers having access to two new mega-merged North American railroads eagerly soliciting their long haul traffic for movement over their respective "seamless" merged lines, from origin to destination. If this should actually occur, it would provide improved transportation service and competitive freight rates, but this scenario is unlikely.

The more likely scenario, as supported by the arguments made in this discussion paper, is that the railroad mega-mergers would create two "gorilla" transcontinental railroads with unprecedented market power. The Canadian experience over the past decade has been that a duopoly, protected by high economic barriers to market entry, is likely to engage in "conscious parallelism" to maximize and protect freight revenues and avoid price retaliation elsewhere. There could be some improvement in service but the shipper traffic would likely be divided evenly along the respective corridors. Price competition for market share would not occur because shippers would be unable to solicit competing bids by selecting routing scenarios allowing them to offer traffic over portions of each of the mega-merged railroads. The new North American railroads would likely be unwilling to provide competitive quotes for proportional movements which U.S. legislation does not require in any event.

THE REAL BENEFITS OF THE PROPOSED CN/BNSF MERGER AND WILL THEY BE SHARED WITH SHIPPERS?

The CN and BNSF press releases on their proposed merger estimate total cost savings of the transaction to be $900 million over three years or about $300 million annually. Viewed in the context of the combined 1998 revenues of $16 billion for the two railways, the expected efficiency and productivity gains are not large. Hence, there would be little opportunity for sharing merger efficiencies and productivity gains with shippers. As argued earlier in this paper, the real commercial impact of the proposed merger would be on the net revenues of the merged entity resulting from single line long haul service.

The recent U.S. mergers to create the BNSF and UP railroads, and the Norfolk Southern and CSX acquisition of Conrail, all experienced different degrees of service disruptions, some of which continue to the present day. These mergers, however, involved the rationalization of the operations of "parallel" railroads which led to operating problems and traffic congestion. Unlike these earlier mergers, the proposed CN/BNSF merger is an end-to-end merger involving minimal duplicative trackage and little overlap of manpower, operations and facilities.

Because of this negligible overlap, and the minimal projected 1.5% downsizing of the total combined workforce of 67,000 employees, there is little reason to believe that the proposed CN/BNSF merger should result in similar service and congestion problems. Nevertheless, close oversight of the merger by Canadian and U.S. regulatory authorities is recommended and the service guarantees offered by both CN and BNSF should be formalized by rulemaking to make them legally enforceable by shippers.

CONCLUSION

Today's railway system gives captive shippers on the lines of CP and CN competitive choices between:

- the two Canadian railways
- two U.S. Class 1 railroads operating east of Chicago, i.e. CSX and Norfolk Southern
- two U.S. Class 1 railroads operating west of Chicago, i.e. BNSF and UP

This provides a total of six alternatives, at least four of which are available on transborder shipments to any U.S. destination. Under the merger options discussed in this paper, however, the number of independent railways would be reduced to five if the CN/BNSF merger is approved. With a possible CP/UP merger, only four railways would remain which could rapidly be reduced to just two North American mega-railways following mergers with the two eastern U.S. carriers.

The Executive Summary to this research paper reviews the competitiveness implications for shippers, of these merger scenarios. The research paper reviews the impact of these mergers, which puts at risk Canada's competitive access provisions. The increased market dominance of the merged entities emphasizes the need for greater shipper protection in both Canada and the U.S. The following recommendations for responding to the proposed CN/BNSF merger and the likelihood of further railway mergers are explained in the Executive Summary:

- preserve and enhance Canada's competitive access mechanisms
- STB to enhance shipper protection to offset the increased market dominance of the merged entities
- formalize CN and BNSF rate and service guarantees through rulemaking
- abolish tariffs which restrict competition
- order new railway running rights to transborder interchange points
- create an effective dispute resolution mechanism (e.g. FOA) applying to cross border single line through rates and services
- create an effective North American regulatory oversight to oversee North American railroads.

APPENDIX I – CN TARIFF 6061-A

CANADIAN NATIONAL RAILWAY COMPANY

FREIGHT TARIFF CNR 6061-A
CANCELS CNR 6061
FREIGHT TARIFF CNR 6061-A CONTAINS ALL CHANGES

SPECIAL ARRANGEMENTS TARIFF
-OF-
RULES AND REGULATIONS
APPLYING ON
LUMBER AND RELATED COMMODITIES

GOVERNED BY CN TARIFF 6400 SERIES AND OTHER PUBLICATIONS SPECIFIED HEREIN OR INCORPORATED BY REFERENCE

ISSUED: FEBRUARY 26, 1999 EFFECTIVE: MARCH 18, 1999

EXPIRES: JULY 31, 1999 UNLESS SOONER CANCELLED, CHANGED OR EXTENDED

Issued by Nikki Smith Director Pricing Services, Canadian National Railway Company, PO Box 8100, Montreal H3C 3N4
Requests for CN Tariffs: 1-877-CNTARIFF (1-877-268-2743)

(CN 6061-A) (200)
(Printed in Canada)

ITEM 120
NON-APPLICATION OF SWITCHING ABSORPTION

Switching charges at origin will not be absorbed and will be in addition to freight charges.

Rates in this tariff do not include any additional charges at destination. If such charges are assessed, the carrier applying same will be responsible for collection.

ITEM 130
CAPACITIES AND DIMENTIONS OF CARS

For capacities and dimensions of cars, refer to the official railway equipment register, RER 6410-series, RER Publishing Corporation, Agent.

ITEM 140
SHIPMENTS INVOLVING CN AS ORGINATING OR INTERMEDIATE CARRIER (SEE NOTE)

1. Except as otherwise provided in individual items, the rates published in applicable tariffs may not be applied as proportional rates for use in constructing all rail combinations of rates in lieu of joint through rates from Canada published in this or other tariffs on traffic that includes CN as a participating carrier in the routing.
2. Except as otherwise provided in individual items, the rates published in applicable tariffs may be applied as factors in rebilling traffic to any destination to which joint through rates are published in this or other tariffs on traffic that includes CN as a participating carrier in the routing.
3. Except as otherwise provided in individual items, the rates published in applicable tariffs may be applied as factors for use in constructing all rail combinations of rates as provided for by AAR Accounting Rule 11 in lieu of joint through rates from Canada published in this or other tariffs on traffic that includes CN as a participating carrier in the routing.

NOTE: Provisions of this term will not apply on traffic moving to Alaska via CN Aquatrain.

ITEM 180
TERMINAL OR TANSIT PRIVILEGES OR SERVICES

In the absence of specific provisions in this tariff to the contrary, shipments transported under this tariff will be entitled to such allowances and privileges and subject to such charges, rules and regulations of originating carriers parties to this tariff, for property while in their possession, and of any of the intermediate and/or delivering carriers parties to this tariff, for property while in their possession, as are provided in tariffs lawfully in effect, providing for terminal and transit privileges or services.

ITEM 570
DIVERSION IN TRANSIT OF CARLOAD TRAFFIC
(Concluded)

4. CN will NOT be responsible for additional charges that may be incurred when the diversion cannot be accomplished at the desired location.
5. CN will NOT be responsible for any charges accruing on cars delivered to connecting carriers, other than the absorption of reciprocal switching charges that are authorized by CN switching absorption provisions.
6. The provisions of this item will not supersede the provisions of any governing contract or tariff that may prevent the car from being diverted.

ITEM 571
NON COMPLIANCE OF CN PRICE PUBLICATIONS

Unless otherwise specified, a charge of $1224.00 (Canadian funds) will be assessed to the party requesting the rebill or diversion of a railcar, originating on CN, to a destination not specified in an applicable CN price publication.

This charge will be assessed in accordance with the following:

1. If a rail car is billed under the provisions of AAR Accounting Rule 11 to a destination not specified in the applicable CN price publication.
2. If a rail car is rebilled subsequent to it reaching final destination as specified in shipper's Bill of Lading or diversion request.

ITEM 580
CARS IMPROPERLY LOADED – ADJUSTMENT
CARS OVERLOADED – REMOVAL OR TRANSFER OF EXCESS WEIGHT
SERVICES AND CHARGES

The provisions of CN Tariff 6014-series will be applicable.

NOTE: Will not apply for account of ACR

SHIPPERS' SUMMIT

Canadian Chemical Producers' Association

Canadian Fertilizer Institute

Canadian Industrial Transportation Association

Atlantic Provinces Transportation Commission

Mining Association of Canada

Alliance of Manufacturers & Exporters Canada

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Lisa MacGillivray

15 Dec 1999

The Honourable David Collenette
Minister of Transport
Place De Ville, Tower C
330 Sparks St.,
Ottawa, ON K1A 0N5

Canada's largest shipper organisations met as a group for the first time at the end November to discuss the recommendations put forward by Arthur Kroeger and Justice Willard Estey. We focussed exclusively on matters pertaining to rail competitive access provisions and dispute resolution mechanisms.

Shippers and industry associations who participated in the Shippers' Summit were not considered to be primary stakeholders by either Justice Estey or Arthur Kroeger. Over the past year some non-grain shippers have been kept informed in a peripheral manner. At no time were non-grain shippers directly involved in the working groups on any topics including those dealing with rail competitive access provisions or dispute resolution mechanisms. During the Kroeger process, it became apparent that policy modifications pertaining to these specific topics could not be restricted to the grain industry but must also apply to shippers of all commodities.

The Shippers' Summit initiated an ongoing policy development process among the participants, which resulted in a discussion paper containing an initial package of comments on competitive access provisions and dispute resolution mechanisms.

Based on the discussion paper, the participants in the Shippers' Summit offer the following for your consideration:

Interswitching, Competitive Access Rates, Competitive Line Rates & Extended Interswitching

The Competitive Access Rate or CAR embodies the principle of interswitching for shippers who are outside the limits for regulated interswitching. This provision would streamline and simplify the existing competitive access provisions of the Act by replacing Competitive Line Rates and Extended Interswitching with CAR.

Limited Running Rights

Following the lead of Justice Estey, the Shippers' Summit participants have considered a running right methodology that incorporates "reverse onus", but also suggests reasonable limitations to ensure that the remedy will not be used indiscriminately.

/2 . . .

Final Offer Arbitration

A more streamlined and flexible single tier Final Offer Arbitration process is suggested. It provides a less costly, more expeditious undertaking for both parties, while accommodating more complicated issues with a more comprehensive process.

Branch Line Conveyance

The provisions that outline how branch lines are to be conveyed are in need of fine-tuning to ensure shippers can optimize their rail options. The Shippers' Summit participants are developing a number of proposals that will enhance conveyance for the benefit of shippers, short line railways and the communities they serve.

This brief summary outlines our perspective on achieving the balanced rail transportation system required by both shippers and railways. We believe that the elements of the Shippers' Summit discussion paper provide a basis for developing, with your officials, policy initiatives needed to provide a competitive rail system for all Canadians in today's increasingly global economy. The discussion paper can be provided to you upon your request. For more information, please contact Ms. Lisa MacGillivray at (613) 235-2482.

Yours very truly,

Canadian Chemical Producers' Association

Canadian Fertilizer Institute

Canadian Industrial Transportation Association

Mining Association of Canada

Atlantic Provinces Transportation Commission

Alliance of Manufacturers & Exporters Canada

SHIPPERS' SUMMIT

Discussion Paper:

Enhancing Rail Competitiveness in Canada

December 1999

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Table of Contents

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Interswitching, Competitive Access Rates, CLRs & Extended Interswitching

Interswitching

Regulated interswitching allows shippers who are captive to the lines of a single railway, primarily in urban areas, to secure rates and services from competing railways without the potential threat of rate or service abuse. Regulated interswitching has existed in Canada as a means of obtaining rail competitive access for many years. Agency-established interswitching rates are an important component of the competitive access provisions of the Canada Transportation Act and reflect the broader policy objectives set out in Section 5 of the Canada Transportation Act, 1996 (CTA, 1996).

We strongly support the continuation of the regulated interswitching provisions in legislation.

The existing CTA interswitching provisions should be broadened to permit the transfer of goods at all interchanges irrespective of the ownership of the lines over which the traffic moves to and from those interchanges.

Competitive Access Rates (CAR)

In order to foster increased competition between railways, both the extended interswitching and competitive line rate provisions of the CTA should be repealed and replaced by a new competitive access provision which we call "*CAR*".

CAR is a competitive access rate, which is designed to enable a captive shipper to move goods to or from an interchange with a connecting, competing railway under a pre-determined set-rate formula, which is established by the Canadian Transportation Agency. A captive shipper is defined as a shipper located on the line of a single railway at either the origin or destination of the traffic movement.

CAR movements use the Agency's regulated interswitching rates for the first 30 kilometres of the movement [radial distance] and other revenue-based rates, such as a railway's average revenue-per-tonne-kilometre [for the specific commodity in question], for the balance of the movement to or from the interchange. A CAR would be established by the Agency by order or by regulation and, once established, be placed in either a published tariff or confidential contract at the option of the shipper and the local railway over whose line the CAR applied.

CAR would be established, on request of a captive shipper, to or from the nearest interchange with a connecting railway of the shipper's choice in the reasonable direction of the haul over a route designated by the shipper.

A CAR would be limited to not more than fifty percent of the total rail distance between the origin and the rail destination or 1,200 km, whichever is greater. Shippers who use a CAR to move their freight to a connecting railway would not be permitted to seek final offer arbitration to resolve rate disputes with the originating railway that is subject to the CAR provisions.

Shippers located on the lines of federal railways, where those lines have been transferred since the Canada Transportation Act was enacted in 1996 or are subsequently transferred to provincial short line railways, would continue to be permitted to request a CAR from the interchange where the short line railway [provincially regulated] connects with the federally regulated railway to or from the next interchange with a connecting railway.

CAR is designed to replace both the extended interswitching and competitive line rate provisions of the CTA, doing away with costly and time consuming applications and hearings before the Agency as well as the unnecessary section 27 test of substantial commercial harm. Given that CAR streamlines and simplifies the existing competitive access provisions of the Act, CAR would therefore also require fewer regulatory resources to administer.

CAR differs from existing CLR' s in that it is also designed to enable captive shippers to secure competitive bids on rates and services from both the local railway, to which the shipper is captive, and from the competing railway at the interchange. Under the present CLR provisions, the originating carrier is considered to have "lost" the traffic for the duration of the CLR application. This, we suggest, will encourage greater competition between the local railway to which the shipper is captive and the connecting railway which the shipper wishes to access at the interchange and allows the originating railway the opportunity to re-bid on the traffic.

The CAR principle recognizes that captive shippers do not want to switch their traffic to a second railway if at all possible but, at the same time, also recognizes that captive shippers are entitled to rates which reflect rail-to-rail competition even if such competition does not physically exist at origin or destination. Finally, CAR, using the local railway's own revenue-per-tonne-kilometre data as a basis for setting the rate to the interchange, reflects commercial rate-making principles.

Extended Interswitching and Competitive Line Rate (CLR) Provisions

Applying for a competitive line rate (CLR) is no longer a viable, alternative option for captive shippers in Canada. In reality, the use of the CLR provisions of the CTA presupposes that Canadian railways will compete for the traffic of a captive shipper.

In actual fact, Canadian railways have not competed with one another for traffic using this provision since 1991. Indeed, the *National Transportation Act Review Commission* (NTARC), revealed in its 1993 report to Parliament that:

> *"CN and CP Rail have effectively declined to compete with each other through CLRs, and as a result the provision is largely inoperative."* (P.131)

More recently, the Hon. Justice Willard Z. Estey, CC, QC, in his final report on the *Grain Handling and Transportation Review*, dated December 21, 1998, stated with respect to railway competition, the following:

> *"Many of those appearing before the Review, with the exception of the railways, maintained that there is no competition in the real sense of that term between the two railways...."* [Page 35]

Given that CAR's will be applicable to any traffic moved beyond a 30-kilometre distance, or a 40-kilometer distance within the 30-km radius, there will be no need for a continuation of the competitive line rate provisions in legislation. In this regard, existing competitive line rate provisions of the Act should be repealed.

Extended interswitching presently applies to traffic which is moved outside the 30 kilometre regulated interswitching distance where the shipper is *"reasonably close to the interchange"* [s. 127 (4) CTA]. Like competitive line rates, the continued need for extended interswitching will also cease with CAR. In this regard, the existing extended interswitching provisions of the Act should also be repealed.

Repeal of Section 27 of the CTA, 1996

Section 27, added to the legislation in 1996, requires the Canadian Transportation Agency, in any rate or service application before it, to determine that the shipper making the application will suffer *"substantial commercial harm"* (s. 27 [2]) if the relief sought before the Agency is not granted. This test, we suggest, is an onerous task when one considers the meaning of *"substantial harm"* under any definition. Both the *extended interswitching* and *competitive line rate* provisions of the Act have been considerably weakened by the inclusion of section 27 (2) and (3). Section 27, in our view, is unnecessary and constitutes a major barrier to competitive access relief before the Agency.

For these reasons, section 27 should be repealed.

Repeal of Section 112 of the CTA, 1996

It appears redundant that a quasi-judicial regulatory body must be reminded to render decisions that are commercially fair and reasonable to all parties. The participants of the Shippers Summit deemed this clause unnecessary.

Limited Running Rights

Section 138 of the *CTA* provides for running rights. The existing provisions only apply to (and are available to) federal railways and require an order of the Agency having regard to the public interest. The participants of the Shipper Summit discussed several general amendments to the *CTA, 1996* as well as placing some reasonable limitations on the use of running rights.

The general amendments to running rights address several shortcomings of the current legislation. First, the Limited Running Rights provisions will be available to any person (the "Applicant") wishing to operate trains and/or crews over the line of a federally regulated railway. Secondly, in order to adequately protect public safety there would need to be a requirement that any railway utilizing running rights comply with federal rail safety requirements imposed upon it by the *Railway Safety Act*. Thirdly, any railway opposing a running rights application will be required to establish that granting the remedy "would not be in the public interest".

This "reverse onus" requirement is not unusual. A similar provision was contained in the *National Transportation Act, 1987* (*NTA, 1987*) as it applied to a shipper opposing an application by a railway company to sell, lease or otherwise transfer a line of railway. By placing the onus on an opponent to a running rights order to demonstrate the order is not in the public interest, effect will be given to the pro-competitive intent of expanded running rights while conferring discretion upon the Agency to deny an order where appropriate.

Finally, the compensation, service provisions and operating conditions to the "Owning Railroad" will be established through agreement between the Applicant and the Owning Railway; if no mutual agreement can be reached then compensation, service provisions and operating conditions shall be set by the Agency recognizing that running rights is a pro-competitive remedy.

The Shippers' Summit group felt that certain reasonable restrictions should be applied to running rights to limit their applicability. First, only shippers that are captive to the lines of a single railway under federal jurisdiction may apply for limited running rights or request any other person to exercise those rights on its behalf. Secondly, there should be some restriction on the distance for which a running right should be applicable. The running right portion of the movement should be limited to the nearest interchange with a connecting carrier on a route designated by the Applicant. This would not exceed a maximum of 1,500 km. If the shipper is captive to the same railway at both origin and destination, then the running rights will apply to the entire movement without distance limitation.

These reasonable limitations provide a balanced approach to an issue. which has been perceived as contentious among the stakeholders in the Kroeger process.

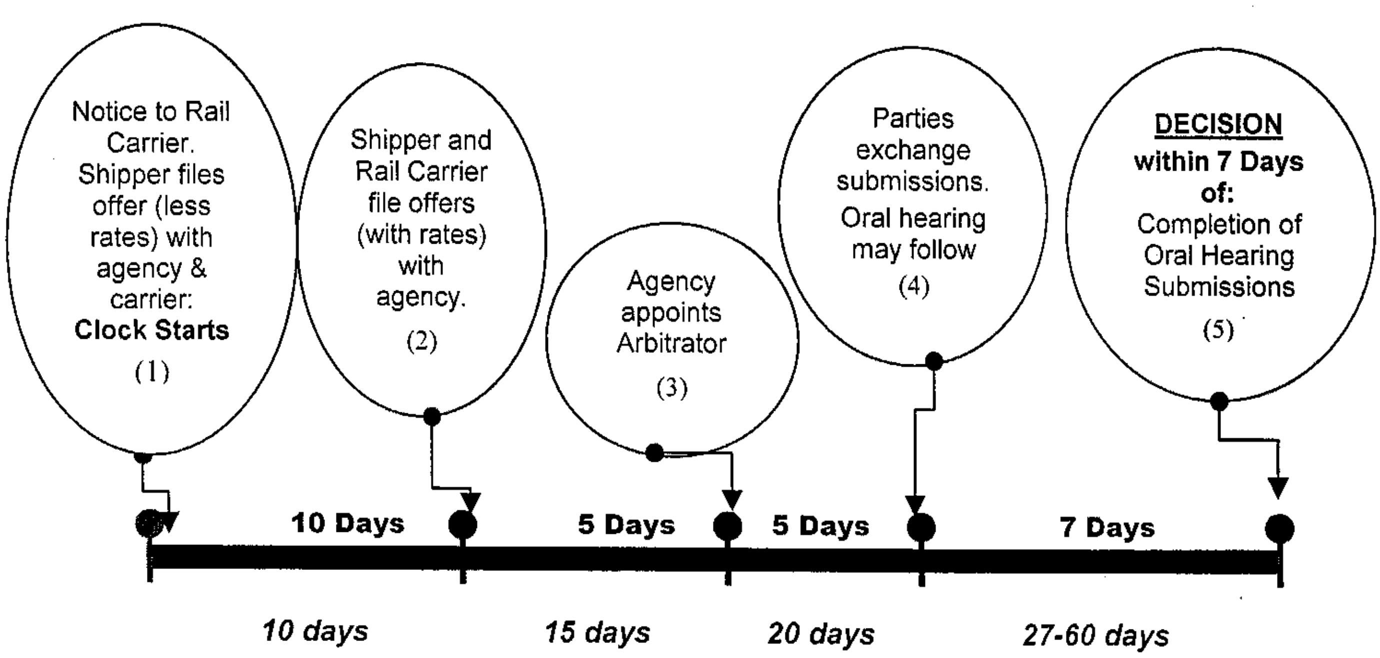
Final Offer Arbitration

The members of the Shippers' Summit recognized the need for a Final Offer Arbitration (FOA) process that will provide all shippers with a dispute resolution process that is quick, effective and low-cost. The model below satisfies those requirements and avoids two major flaws inherent in the recommendation from *Consultations on the Implementation of Grain Handling and Transportation Reform:* the proposed checklist and the two-tier arbitration process.

The requirement to satisfy the items included in the recommended checklist will only offer an opportunity to delay, impede and otherwise prolong the process as the determination as to whether or not the list has been completed will be contentious.

Similarly, the addition of a panel of three arbitrators will only impede a timely decision and triple costs for the participants. In addition, there is no logic to pegging the nature of a resolution process to an arbitrary "value" of $750,000. By definition, one process is less comprehensive (and therefore less thorough) than the other. It is a bold recommendation that assumes the arbitration needs of a "small" shipper commands a lesser process than those of a large commodity shipper.

An Improved FOA Process



Explanation of Action Points

1. All Objections heard by Agency (no external appeals) within 10 days after filing of notice.
2. Simultaneous exchange of offers.
3. Arbitrator must be selected within 15 days after submission of shipper's offer
4. Parties may agree to Oral Hearing or Arbitrator may determine one is required. Hearing must be completed within a time frame that permits a decision within 60 calendar days of the date of filing of Notice.
5. Decision within 7 days after receipt of submissions or end of hearing.

The above FOA process has distinct advantages over the proposals put forward in the Kroeger Process. The process is the same for all applicants and relies on a single arbitrator. It incorporates the simultaneous offer exchange and is flexible enough to provide an efficient, cost-effective resolution to straightforward cases and a more thorough examination where required. It is an important feature the FOA process that a determination on the nature of the process required is made during the arbitration, with full knowledge of all aspects of the case.

Branch Line Conveyance

The underlying justification for the revisions to the Canada Transportation Act, 1996 pertaining to branch line conveyance and abandonment was to allow Canada's Class 1 railways greater flexibility to convey or discontinue marginal or uneconomical lines with little government intervention. The shipping community supported this policy initiative in that there was a belief that transferring branch lines to lower-cost operators would prevent the total loss of rail service through abandonment.

However, it has become apparent that some revision to the conveyance and abandonment process is required in order to ensure that branch lines are conveyed in such a manner that rail customers might continue to receive an adequate and reasonable level of service.

Shippers believe branch line conveyance should represent improved service but after conveyance, many shippers find themselves captive to a captive short line. This causes serious concern as these new short lines have no rights and little negotiating leverage with the large Class 1's either when trying to obtain lines at reasonable prices, or in the revenues they receive from the Class 1's or in the rights they can exercise as railways in conjunction with the larger Class 1's.

Problems with the CTA Line Conveyance Process

- Federally requested railways (Primarily CN and CP) can segment sections of lines for sale or lease, making the section of track uneconomic to operate as a short line railway.
- CN and CP do not have to negotiate *"in good faith"*. They can essentially dictate the terms of the line sale or lease to a prospective buyer/lessee.
- CN and CP can dictate the revenues, which the short line will earn from the line [Class 1's generally pay the short line a set fee per car for moving cars to and from interchanges].
- CN and CP can even refuse to sell or lease the line unless the short line agrees to their terms, for example in the case of a breakdown in the process.
- CN and CP can also refuse to sell/lease the line if certain actions are contemplated by the new operator [i.e., exercising running rights].

Remedies

- Enable the Agency, upon complaint, to intervene in the line transfer process where any person believes that the owning railway is segmenting and/or de-marketing the line in an uneconomic manner.
- Enable the Agency, upon complaint, to intervene in the line transfer process where any person believes that the owning railway is not negotiating in "good faith". If this is the case, the Agency should have the ability to fix the terms of the sale or lease, including the price.
- Allow potential short line operators to go to arbitration if an agreement on the terms and conditions of the sale/lease can not be agreed on [including price].